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UNCLAS SECTION 01 OF 02 HARARE 002821

SIPDIS

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¶E. 0. 12958: N/A
TAGS: ECON EFIN ETRD ZI
SUBJECT: 2003 Budget Will Not Save Economy

Ref: a) Harare 2546 b) Harare 2679

¶1. Summary: Through its 2003 interventionist budget proposal, the GoZ hopes to revive the country's economy. It seeks to expand price controls, shut down the paralle exchange, curb the informal export sector and raise most taxes. We believe this approach will have the opposite effect, ensuring high inflation and a continued business exodus to the informal economy. End Summary.

The fiscal equation

¶2. The GoZ proposes:

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revenue  -     Z$ 541 billion (US$ 338 million)
spending -     Z$ 782 billion (US$ 489 million)
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deficit  -     Z$ 242 billion (US$ 151 million)
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Admittedly, the GoZ is making an effort to restrain domestic spending. It limits assistance to "new farmers -- an impassioned funding priority -- to a nominal 50 percent increase (and significant decrease in real terms). It raises total Zimdollar expenditures by "only 95 percent over 2002, shy of its own optimistic inflatio expectation of 96 percent (the IMP forecasts 522 percent).

¶3. But by disclosing Zimdollar but not forex transactions, the GoZ conceals an external shortfall tha exceeds the US$ 151 million deficit many times over. Specifically, the GoZ does not reveal how much it expect to earn by withholding export proceeds, or how much it will have to spend on imported food, fuel and energy. This lapse in transparency makes it difficult to gauge the GoZ's 2003 deficit. An internal Reserve Bank workin paper suggests the GoZ will have to spend US$ 506 millio next year on the food, fuel and energy imports alone, an another US$ 426 million on other essential external payments. With.foreign exchange inflows projected at only US$ 350 million, we arrive at an external accounts financing deficit of US$ 678 million, or four-and-a-half times the US 151 million domestic deficit. The total shortfall may thus be as high as US$ 829 billion.

¶4. Most problematic is that the GoZ will suffer from a very restricted revenue base in 2003, despite raising import duties and effective income taxes. Finance Minister Herbert Murerwa characterized revised brackets, which exempt twice as much income in Zimdollar terms, as tax relief and a boost to aggregate demand. In all likelihood, however, inflation-induced bracket creep means most Zimbabweans will pay more taxes.

The death of exports?

¶5. The GoZ has been addressing huge budget deficits in two ways: a) printing more money (supply is now growing by about 120 percent annually) and b) importing less food, fuel and energy than its population needs. In the 2003 budget, the GoZ proposes two additional measures:

- Eliminate the parallel exchange market. If the Zimdollar traded at the official rate of 55:1 rather tha the present 1580:1 parallel rate, imports would suddenly cost 96 percent less. Hence the wishful GoZ believes it can end parallel trading by outlawing exchange dealers .while ignoring the fundamentals behind the Zimdollar's demise.

- Tax a larger portion of export revenue. The GoZ will now collect as much as 100 percent of an exporter's fore revenue, versus the previous 40 percent. Exporters will surrender 50 percent of revenue for exchange at the official rate upfront and deposit the other 50 percent into a Reserve Bank forei gn currency account (FCA). The exporter petitions the Reserve Bank for the right to spend the remaining portion of earnings with a 60-day

deadline. If he fails to beat the 60-day clock, the Reserve Bank keeps the other half of his revenue. Assuming an exporter needs to take a trip 65 days after receipt of earnings, for example, he would not be able t tap his revenue. (Comment: On a brighter note, exporters no longer have to dread future tax hikes, since the effective rate has reached nearly 100 percent of revenue.) The GoZ will also begin pre-inspecting exports, making it harder for firms to underinvoice and dodge these onerous taxes.

New Price Controls

¶6. The GoZ announced a wide range of new price freezes geared mostly to agricultural inputs such as seeds, chemicals, machinery, fertilizers. Recognizing that it can only spend a small amount on new farmers -- Z$ 4.1 billion (US$ 2.6 million) for irrigation development and Z$ 1 billion (US$ 625,000) for mechanization -- the GoZ is trying to get more bang for its buck by holding costs down. If present policies are any indication, these new price controls will only lead to shortages and black-marketeering.

Comment

¶7. The budget is laden with inconsistencies, perhaps because it amalgamates the views of civil service economists and socialist politicians. In general, the economists give the diagnosis and the politicians the remedy, making for some interesting disconnects. The Go both subsidizes exporters through ultra-low borrowing rates (ref b), then knocks them back down many times ove through additional revenue withholding. Export earnings will be US$ 1.4 billion in 2002, down from US$ 3.1 billion in 1997 but still too large for the GoZ's heralded Z$ 25 billion (US$ 16 million) exporters' loan fund or Z$ 250 million (US$ 281,000) mining sector fund to have an impact. As a result, the Zimbabwe will continue to destroy its exporters, one of the only remaining sources of forex.

¶8. The Finance Minister made much of his goal to reduce inflation to double-digits, but the GoZ offered only mor price freezes as a plan. They have caused rather than alleviated inflation, whether or not the GoZ's consumer price index recognizes it. Without a commitment to tighten money supply, the 96 percent inflation rate for 2003 is no more plausible than a banner tobacco harvest and a 55:1 exchange rate.

Sullivan

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